Preemption of New York Escrow Account Laws

Summary Conclusion: Federal law preempts, for federal savings associations, provisions of New York state law requiring payment of interest on mortgage escrow accounts. In addition, a reference to federal law and state law in a mortgage document does not establish an obligation to pay escrow interest that would not otherwise exist.

Date: October 6, 2003

Subjects: Home Owners' Loan Act/Savings Association Powers

P-2003-7

Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552 • (202) 906-6251

P-2003-7

Chief Counsel

October 6, 2003

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Re: Preemption of New York Laws Purporting to Regulate Escrow Accounts

Dear [ ]:

You have asked whether federal law preempts, for a federal savings association, New York state requirements to pay interest on escrow accounts established pursuant to mortgage loan agreements. You also ask whether a mortgage document containing a choice of law provision that references both federal law and New York law establishes a contractual provision to pay escrow interest.

We conclude that the New York requirements about which you inquire are preempted by federal law from applying to federal savings associations. We also conclude that the reference to federal law and state law in a choice of law provision includes the preemptive effect of federal law and does not establish an obligation to pay escrow interest that would not otherwise exist.

Background

Your client, [ ] (Bank), is a state-chartered commercial bank supervised by the FDIC. The Bank is the successor, by merger in [ ], to the former [ ] (Association), a federal savings association. You have provided us with the following information in support of your inquiry.

Before Association was merged into Bank, Association made residential mortgage loans. Association sold certain loans, but retained the servicing on such loans. With respect to a particular mortgage loan that Association made and sold, but for which the Association retained the servicing, the borrowers have alleged in a lawsuit that Association failed, in violation of New York law, to pay interest on escrow funds

Association held for the borrowers.[1] One section of the mortgage document[2] signed by the borrowers provides that the lender is not required to pay any interest or earnings on escrow funds unless the parties agree in writing that the lender will pay such interest or the law requires the payment of interest on escrow funds.[3] Another section of the mortgage document provides that it is governed by "federal law and the law that applies in the place where the Property is located." The property securing the mortgage is located in the State of New York.

You indicate that several provisions of New York law are at issue. One provision requires every "mortgage investing institution," including federal savings associations, that maintains an escrow account pursuant to a mortgage agreement to pay interest on the funds on deposit in that account.[4] The same provision also authorizes the New York banking board to prescribe by regulation the method of computing interest. A second provision of New York law authorizes the state banking board to prescribe by regulation a minimum rate of interest that a mortgage investing institution is required to pay on escrow accounts maintained with respect to mortgage loans.[5] Another section of the same law provides that the payment of interest shall not be required on escrow accounts where "the payment of such interest would violate any federal law or regulation."[6] Two other provisions of New York law require mortgage investing institutions to pay interest on escrow accounts established for payment of real property taxes and hazard insurance premiums.[7] Finally, New York State Banking Department regulations prescribe the method of computing interest that should be paid on escrow accounts.[8]

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[1] [ ]

[2] The mortgage document at issue is titled "Mortgage" and is denominated "New York – Single Family – FNMA/FHLMC Uniform Instrument."

[3] There was no written agreement by Association to pay interest on the funds it held in escrow for the borrowers and Association did not pay such interest.

[4] N. Y. Gen. Oblig. L. § 5-601 (McKinney, WESTLAW through L.2003). The term "mortgage investing institution" is defined to include any "federal savings and loan association." N.Y. Banking L. § 14-b(5) (McKinney 2001).

[5] N.Y.Banking L. § 14-b(1) (McKinney, WESTLAW through L.2003).

[6] N.Y. Banking L. § 14-b(4)(ii) (McKinney, WESTLAW through L.2003).

[7] N.Y. Real Property Tax L. § 953(2) (McKinney, WESTLAW through L.2003); N.Y. Banking L. § 6-k(2)(b) (McKinney, WESTLAW through L.2003).

[8] N.Y. Comp. Codes R. & Regs. tit. 3, §10.1 (WESTLAW through March 15, 2003).

Discussion

Federal law preempts for federal savings associations the provisions of New York law discussed above, which purport to require the payment of interest on mortgage related escrow accounts. We have addressed this issue on several previous occasions in several different formats.

First, OTS regulations, promulgated pursuant section 5 of the federal Home Owners' Loan Act,[9] provide that OTS occupies the fields of lending regulation and deposit-related regulated regulation for federal savings associations.[10] OTS regulations provide illustrative examples of the types of state laws that are preempted, as well as the types of state laws that generally are not preempted.[11] Section 560.2(b)(6) of OTS's lending regulations specifically preempts state laws that purport to impose requirements regarding escrow accounts.[12]

Second, in a 1991 opinion involving a provision of New York law, OTS concluded that federal law preempts a state law requiring the payment of interest on escrow accounts and, therefore, such a law is not applicable to federal savings associations.[13] Third, OTS's predecessor agency, the Federal Home Loan Bank Board (FHLBB), had concluded that federal savings associations are not obligated to pay interest on escrow accounts absent an express contractual provision to the contrary, and that state laws purporting to require associations to pay interest on escrow accounts are preempted.[14] We direct you to the reasoning and analyses set forth in the OTS and FHLBB opinions. In 1998, OTS noted the continued validity of the conclusions in these

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[9] 12 U.S.C.A. § 1464 (West 2001).

[10] 12 C.F.R. § 560.2(a) (Lending and Investment) and 12 C.F.R. § 557.11(b) (Deposits) (2003).

[11] See 12 C.F.R. § 560.2(b) and (c) (2003).

[12] 12 C.F.R. § 560.2(b)(6) (2003).

[13] Op. OTS Chief Counsel (January 3, 1991). The opinion concluded that § 953 of the New York Real Property Tax Law is preempted "to the extent it purports to regulate interest payments, service charges, and the disclosure of information on escrow accounts for mortgages between Federal savings associations and their borrowers."

[14] Op. FHLBB General Counsel (August 13, 1985) and Op. FHLBB General Counsel (September 24, 1984). *See also*, Wisconsin League of Financial Institutions v. Galecki, 707 F.Supp. 401 (W.D. Wisc. 1989), which found a Wisconsin law regulating tax escrow accounts maintained in connection with mortgage loans preempted. The law required lenders to provide certain disclosures and notices to borrowers, and to pay interest on escrow accounts under certain conditions. Although the court's decision focused on the state disclosure requirements, the court stated, "federal regulation in this area preempts state regulation of mortgage loan escrow accounts and disclosures, ..." 707 F. Supp. at 406.

OTS and FHLBB opinions regarding federal preemption of state laws purporting to regulate escrow accounts.[15]

You also ask us to confirm that a choice of law provision in the mortgage document that invokes federal law and the law of the state where the real property is located, in this case New York, does not establish a contractual agreement to pay interest on escrow accounts "as if the preempted provisions of New York State law were not pre-empted." The reference in the mortgage loan document to the law of the place the property is located (New York), together with a reference to federal law, is insufficient to establish a contractual agreement to pay interest on escrow funds. The reference to federal law and state law in the same provision of the mortgage document includes the preemptive effect of federal law. In other words, Federal law continues to operate so as to preempt an impermissible state requirement. The reference to state law does not nullify or negate the preemptive effect of federal law. The Supreme Court has recognized that even where a federal regulation arguably incorporates state law, "the incorporation of state law does not signify the inapplicability of federal law."[16] New York law also appears to recognize the applicability of federal law because New York law specifically provides that the payment of interest on escrow accounts is not required where such payment would violate any federal law or regulation.

In *de la Cuesta* the Supreme Court also rejected a contention that deeds of trust stating that they were to be governed by the law of the jurisdiction in which the property is located constituted an agreement to be bound by local law. Thus, even in the absence of a specific reference in the deeds to federal law, the Court observed that the " 'law of the jurisdiction' includes federal as well as state law."[17] The Court also noted that the purpose of the language was "not to elevate state law over federal law, but to provide a uniform choice-of-law provision to be used when interstate disputes arose regarding the interpretation of a mortgage."[18]

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[15] *See* Letter dated November 17, 1998 by OTS Assistant Chief Counsel.

[16] *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U. S. 141, 157 (1982) (*de la Cuesta*). The Court explained that a "fundamental principle in our system of complex national polity" mandates that "the Constitution, laws, and treaties of the United States are as much a part of the law of every State as its own local laws and Constitution." *Id.* The provision at issue in de la Cuesta was a due on sale provision; federal regulations permitted federal savings association to use such clauses, but state law limited the use of such clauses.

[17] 458 U.S. 157, n. 12. The "law of the jurisdiction" language at issue in *de la Cuesta* was contained in paragraph 15 of a "uniform mortgage instrument developed by the Federal Home Loan Mortgage Corporation [FHLMC] and the Federal National Mortgage Association [FNMA]" and did not also include a reference to federal law. 458 U. S. 148, n.5. The language that is the subject of your inquiry also appears in paragraph 15 of a FNMA/FHLMC uniform mortgage document and includes a specific reference to federal law.

[18] 458 U. S. 157, n.12, citing the amicus brief filed by the FHLMC and the FHLBB in the de la Cuesta case.

Accordingly, we conclude that the Association was not required to pay interest on the escrow accounts Association held for borrowers. Federal law preempted the New York requirements to pay escrow interest, and the reference in the mortgage document to the law of the place where the property is located does not change this result.

In reaching the foregoing conclusions, we have relied on the factual representations made in the material you submitted to us as summarized herein, Our conclusions necessarily depend upon the accuracy and completeness of those facts. Any material difference in facts or circumstances from those described herein could result in different conclusions.

We trust that this is responsive to your inquiry. If you have further questions, please contact Vicki Hawkins-Jones, Special Counsel, at (202) 906-7034.

Sincerely,

Carolyn J. Buck
Chief Counsel

cc: Regional Directors
Regional Counsel